

INCUBATING GOLDEN EGGS: WHY ATTORNEY ETHICS RULES MAY STIFLE SMALL BUSINESS DEVELOPMENT

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This work explores the impact of the model attorney ethics rules on business incubation. Business incubation is a business support process in which the business incubator provides a variety of support services to client start-up companies. One of the hallmarks of business incubation is the interdependence of business incubators and client companies regarding management and operations. Attorneys can provide valuable services to client companies in business incubator systems, but ethics rules place restrictions on attorneys providing concurrent representation to clients with differing interests and thus, may negatively impact the potential benefits an attorney can provide. In addition, attorneys can serve as valuable sources of financing for the start-up companies through equity compensation schemes. However, ethics rules limit attorney business-dealings with clients to such a degree that small businesses, with no other ability to compensate attorneys, may be cut off from the benefit of attorney advice. This work argues that exceptions to the rules are needed to provide flexibility so that small businesses engaged in business incubation are not cut off from valuable attorney services.

Business incubators are entities set up to facilitate the start-up and growth of entrepreneurial ventures and small businesses. According to the National Business Incubation Association (“NBIA”), “[b]usiness incubation is a business support process that accelerates the successful development of start-up and fledgling companies by providing entrepreneurs with an array of targeted resources and services.”¹ The types of support services offered differ among incubators, but they commonly include rental space, shared basic business services such as secretarial and telephone answering

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¹ NBIA, What is Business Incubation?, http://www.nbia.org/resource_center/what_is/index.php (last visited February 6, 2007).

services, technology support, and financing assistance.² One of the hallmarks of a successful business incubation program is the interconnection between business incubator, start-up client, and the community in general.³ As such, business incubation is heavily dependent upon interpersonal connections, networks, experience, and trust.⁴

Although business incubation programs have shown great promise for stimulating economic development,⁵ the current ethics rules governing attorneys may be hindering business incubators' capacity to assist newborn businesses. Unless stringent consent requirements are met, the rules forbid an attorney from representing two clients whose interests may be incongruous, even though both may benefit from the concurrent representation.⁶ Furthermore, the rules make it complicated for attorneys to accept forms of compensation other than cash,⁷ even though small businesses often find attorney services too expensive to utilize at the earliest stages.⁸ The complexity of compliance with the rules and the uniqueness of the relationships in the incubator context may discourage attorneys from working with incubators.⁹ In addition, the rules may serve as a barrier to the necessary interconnectedness between the incubator and the client company.¹⁰ The discussion below explores these issues, offering guidance to practitioners to avoid common pitfalls, and argues that an alternative to the current rules is needed to accommodate the unique needs of business incubators and other organizations that require mutual dependence and interconnectedness to survive.

² See *id.*

³ See NBIA, Principles & Best Practices, http://www.nbia.org/resource_center/best_practices/index.php (last visited February 6, 2007).

⁴ See NBIA, *supra* note 1 ("[S]ervices are usually developed or orchestrated by incubator management and offered both in the business incubator and through its network of contacts."). Cf. NBIA, *supra* note 3 (Among the best practices for business incubators listed are developing appropriate resource and experience networks, recruiting incubator managers and directors capable of achieving development goals, and making proactive guidance and advice to client companies a top priority.)

⁵ See NBIA, Business Incubation Facts, http://www.nbia.org/resource_center/bus_inc_facts/index.php (last visited February 6, 2007).

⁶ See MODEL RULES OF PROF'L CONDUCT R. 1.7 (2003), available at http://www.abanet.org/cpr/mrpc/rule_1_7.html (last visited February 6, 2007); see also MODEL CODE OF PROF'L RESPONSIBILITY DR 5-105 (1983), available at <http://www.law.cornell.edu/ethics/aba/mcpr/MCPR.HTM> (last visited February 6, 2007).

⁷ See MODEL RULES OF PROF'L CONDUCT R. 1.8 (2003), available at http://www.abanet.org/cpr/mrpc/rule_1_8.html (last visited February 6, 2007).

⁸ See Ellen Rosen, *Step 1 in Starting a Small Business: Hire a Lawyer*, N.Y. TIMES, Nov. 16, 2006, at C6.

⁹ See Gwyneth E. McAlpine, Comment, *Getting a Piece of the Action: Should Lawyers be Allowed to Invest in Their Clients' Stock?*, 47 UCLA L. REV. 549, 567 (1999).

¹⁰ Cf. McAlpine, *supra* note 9, at 575 (arguing that a lawyer is inclined to work more aggressively on behalf of a client where interconnectivity is pronounced, especially where the attorney has an equity stake in the client).

I. WHAT IS SO SPECIAL ABOUT BUSINESS INCUBATION?

Before exploring why the current ethics rules shortchange the business incubation dynamic, it will be useful to detail why business incubators require unique treatment. Business incubation is a relatively new concept in business development. The first American business incubator opened in 1959, but the concept did not become common until the late 1970s and early 1980s.¹¹ During those years, the economy had shifted away from a traditional manufacturing-based economy to one focused on services.¹² As a result, traditional heavy-manufacturing states were left with empty industrial facilities, out-migration, and a largely under-educated and unemployed populace.¹³ Policymakers saw business incubation as a potential solution to these problems.¹⁴ A variety of governmental entities began to invest resources in the development of business incubators.¹⁵

One of the most common classifications of business incubators is the type of client company the incubator targets.¹⁶ The first incubators focused on technology firms or on combinations of light industrial, technology, and service companies—termed mixed-use incubators.¹⁷ While such incubators still exist today, many incubators have become more specialized.¹⁸ Incubators may attempt to maximize efficiency by targeting specific industries or even industry segments, such as food processing, medical technologies, space and ceramics technologies, arts and crafts, and software development.¹⁹ Business incubators are often classified according to the type of sponsoring organization²⁰ or type of community served.²¹

¹¹ NBIA, The History of Business Incubation, http://www.nbia.org/resource_center/what_is/beginnings_of_inc/index.php (last visited February 6, 2007).

¹² See Clovia Hamilton, *High-Tech Transportation Corridors are in Vogue: Proposed Federal Transportation Policy Amendments*, 14 ALB. L.J. SCI. & TECH. 359, 368-69 (2004).

¹³ See *id.*

¹⁴ See *id.*

¹⁵ See *id.*

¹⁶ See NBIA, *supra* note 1. According to NBIA, the business incubator target market breakdown is 47% mixed-use, 37% technology-based, 7% manufacturing, 6% service-based businesses, and 3% community revitalization projects or niche markets. NBIA, Business Incubation Facts, http://www.nbia.org/resource_center/bus_inc_facts/index.php (last visited February 6, 2007).

¹⁷ See NBIA, *supra* note 1.

¹⁸ See *id.*

¹⁹ See *id.*

²⁰ See NBIA, *supra* note 5. Sponsoring organization breakdown is 25% academic institutions, 16% government entities, 15% economic development organizations, 10% for-profit entities, and 10% other types of organizations. About 5% of business incubators are “hybrids” with more than one sponsor; 19% of incubators have no sponsor or host organization.

For the most part, business incubation programs have been highly successful. Studies indicate that community investment in business incubators results in a net gain; business incubators stimulate job²² and wealth creation²³ and reduce the risk of business failure.²⁴ For every \$1 of public investment, incubators generate \$30 of local tax revenue.²⁵ The jobs created by publicly-supported business incubation programs cost an average of \$1,100 each, while other publicly subsidized job-creation programs may cost the taxpayers as much as \$10,000 for each job.²⁶

Clearly, business incubators have tremendous capability to stimulate small business, and a good attorney is critical to the creation of any small business.²⁷ However, the types of entrepreneurs typically targeted by business incubators usually are those with the most difficulty in hiring competent legal assistance.²⁸ Because the purpose of business incubation is to provide start-up companies with the services they need but cannot otherwise obtain,²⁹ it seems natural for business incubators to provide clients with attorney services.

Working with business incubators and other business development programs is also a natural fit for the transactional attorney seeking potential clients or pro bono work.³⁰ Business incubators can be a microcosm of business law concerns often leading many law school legal clinics to utilize business incubators in their programs.³¹ At least one former business incubator director has written that the unique set of skills, experiences, and relationships that attorneys possess make them invaluable in assessing the

²¹ See *id.* In the United States, 44% draw clients from urban areas, 31% draw clients from rural areas, 16% draw clients from suburban areas, and 9% draw clients from outside their region or from outside the United States.

²² See *id.* According to NBIA, every fifty jobs created by a business incubator client results in an additional twenty-five in the community.

²³ See *id.* Business incubator clients generated approximately \$7 billion in revenue in 2001 in North America.

²⁴ See *id.* According to NBIA, 87% of its member incubators' clients remain in business upon exiting the incubation program.

²⁵ See *id.*

²⁶ See *id.*

²⁷ See Rosen, *supra* note 8.

²⁸ See Susan R. Jones, *Justice, Ethics, and Interdisciplinary Teaching and Practice: Promoting Social and Economic Justice Through Interdisciplinary Work in Transactional Law*, 14 WASH. U. J.L. & POL'Y 249, 255-56 (2004).

²⁹ See NBIA, *supra* note 1.

³⁰ See generally Jones, *supra* note 28 (providing an overview of how working with small businesses and small business development institutions represents an excellent opportunity for both altruistic legal practice and transactional legal training).

³¹ See Eric J. Gouvin, *Learning Business Law by Doing It*, BUS. L. TODAY, Oct. 2004, at 53, 54; see also Charles R. McManis, *Answering the Call: The Intellectual Property & Business Formation Legal Clinic at Washington University*, 17 WASH. U. J.L. & POL'Y 225, 226 & 228 (2005).

strength of and assisting the furtherance of any economic development opportunity.³²

However, the distinctive nature of the business incubator-business incubator client relationship poses significant ethical concerns for the attorney providing the assistance. While most of the law assumes that parties to a transaction are self-interested and therefore the attorney representing a particular party needs to be concerned solely with the welfare of that party, business incubators do not neatly fit such a dichotomy.³³ Success in business incubation depends on highly interpersonal relationships between the incubator and client staffs.³⁴ Business incubators need to be proactive in dealing with the problems clients may face, and as such, need to be highly involved in the management and operation of the client firm.³⁵ Furthermore, incubators, operating on tight budgets in order to keep costs low to clients, also need to find the most efficient resources for their own operations.³⁶

Business incubator relationships need to be seen as a group of distinct entities mutually dependent upon a central organization, the incubator, for a variety of necessary services. The incubator is highly interested in the survival and success of its constituent companies in order to ensure that it may itself be able to survive. Thus, any attorney working in a business incubator context, whether representing the incubator, incubator client, or both, needs to be able to keep the entire system in mind when giving advice. The current model ethics rules, however, force an attorney to favor one entity over another.

II. CONCURRENT REPRESENTATION AND EQUITY COMPENSATION: DUTY OF LOYALTY BREACH?

The ethics concerns in question are derivations of basic duty of

³² Al Jones, *Lawyers a Boon to Local Economic Development*, MONT. LAW, Feb. 1995, at 7, 8-10. Jones touts the attorney's "overdeveloped skepticism, analytical ability, and quick access to technical information," client networks, and knowledge of local economic workings as assets critical to successful economic and business development.

³³ See *Worldspan L.P. v. The Sabre Group Holdings, Inc.*, 5 F. Supp. 2d 1356, 1357 (N.D. Ga. 1998) ("A lawyer [generally] may not represent one client whose interests are adverse to those of another current client of the lawyer's, . . . Courts and ethics panels generally take a broad view of this restriction. . . . The rules with respect to concurrent representation of conflicting interests are rooted in a lawyer's duty of loyalty to the client."); Cf. McAlpine, *supra* note 9, at 551-52 ("The law clearly finds it suspicious when a lawyer enters into a business transaction with his own client. . . . The presumption is that the savvy lawyer is using his legal knowledge to take advantage of his unsophisticated client.").

³⁴ See NBIA, *supra* note 3.

³⁵ See *id.*

³⁶ See *id.*

loyalty problems.³⁷ Attorneys are fiduciaries of their clients. As such, they owe their clients a duty of loyalty regarding all matters undertaken. As a part of this duty of loyalty, an attorney is forbidden from assuming any relationship that could potentially hamper his client's interests.³⁸ According to one Court:

It is also an attorney's duty to protect his client in every possible way, and it is a violation of that duty for him to assume a position adverse or antagonistic to his client without the latter's free and intelligent consent given after full knowledge of all the facts and circumstances. . . . *By virtue of this rule an attorney is precluded from assuming any relation which would prevent him from devoting his entire energies to his client's interests.*³⁹

Furthermore, it is unavailing that the attorney's intent and motivation in engaging in such a practice is honest.⁴⁰ The current version of the model ethics rules specifically addresses both concurrent representation of clients with potentially diverging interests⁴¹ and taking an equity stake in a business when that equity stake may impair the attorney's ability to represent the client.⁴²

Despite the discouragement of the rules, such practices are not only useful to the business incubator and incubator client, but they may be necessary. Because of the highly interconnected nature of incubator and incubator clients,⁴³ any attorney working in a business incubation system must be able to divulge information among the constituents and design transactions that are mutually beneficial to all involved. Moreover, because small businesses are traditionally cash-strapped,⁴⁴ equity-for-services arrangements are often attractive for both attorneys and small business clients.⁴⁵ Thus, given the highly interconnected nature of the entities involved in business incubation and the need for alternative forms of compensation for attorneys, exceptions to the current versions of the ethics rules should be recognized in order to allow necessary and effective attorney representation.

³⁷ Paul W. Vapnek, *Ethics and Professional Responsibilities Issues*, in PRACTISING LAW INSTITUTE PLI ORDER NO. 8990, PATENT PROSECUTION WORKSHOP 2006: CLAIM DRAFTING & AMENDMENT WRITING 7, 9 (2006).

³⁸ *See id.*

³⁹ *Flatt v. Superior Court of Sonoma County*, 885 P.2d 950, 958 (Cal. 1994) (quoting *Anderson v. Eaton*, 293 P. 788 (Cal. 1930)).

⁴⁰ *See id.*

⁴¹ *See* MODEL RULES OF PROF'L CONDUCT R. 1.7, *supra* note 6.

⁴² *See* MODEL RULES OF PROF'L CONDUCT R. 1.8, *supra* note 7.

⁴³ *See* NBIA, *supra* note 3.

⁴⁴ *See* Rosen, *supra* note 8.

⁴⁵ *See* John S. Dzienkowski & Robert J. Peroni, *The Decline in Lawyer Independence: Lawyer Equity Investments in Clients*, 81 TEX. L. REV. 405, 416-21 (2002).

A. Conflicts of Interest between Business Incubators and Incubator Clients

Two different sets of model ethics rules exist that provide instructions for conflict of interest situations. Most states have adopted the newer American Bar Association Model Rules of Professional Conduct ("MRPC"), but a few still base their ethics rules on the older Model Code of Professional Responsibility ("CPR").⁴⁶ Despite the evolution of the ethics rules over the years, the concerns affecting representation in business incubation have yet to be resolved.

Under MRPC Rule 1.7(a), "a lawyer shall not represent a client if the representation involves a concurrent conflict of interest."⁴⁷ The rule goes on to declare that a "concurrent conflict of interest" exists when:

- (1) the representation of one client will be directly adverse to another client; or
- (2) there is a significant risk that the representation of one or more clients will be materially limited by the lawyer's responsibilities to another client, a former client or a third person or by a personal interest of the lawyer.⁴⁸

Thus, an attorney is not authorized to represent a client if that representation is either directly adverse to another client or if there is a significant risk of material limitation of responsibilities to another client.

Under the older CPR Disciplinary Rule 5-105, a lawyer is not authorized to accept or continue employment if "the exercise of his independent professional judgment in behalf of a client will be or is likely to be adversely affected" by the acceptance or continuation of the employment, or "if it would be likely to involve him in representing differing interests. . .".⁴⁹ The CPR defines "differing interests" as "every interest that will adversely affect either the judgment or the loyalty of a lawyer to a client, whether it be a conflicting, inconsistent, diverse, or other interest."⁵⁰

Under both sets of ethics rules, the attorney providing services in the incubator context needs to proceed with caution. If the attorney is providing legal advice to multiple incubator clients as well as the incubator, situations may arise where the represented parties' interests are, in the language of the MRPC, directly adverse, or, in the language of the CPR, differing. Such situations may include negotiations or transactions between the incubator and the incubator clients, instances where multiple incubator clients compete in the same industry, and instances of competition between

⁴⁶ MODEL RULES OF PROF'L CONDUCT Preface (2003), *available at* <http://www.abanet.org/cpr/mrpc/preface.html> (last visited February 6, 2007).

⁴⁷ MODEL RULES OF PROF'L CONDUCT R. 1.7, *supra* note 6.

⁴⁸ *Id.*

⁴⁹ MODEL CODE OF PROF'L RESPONSIBILITY DR 5-105, *supra* note 6.

⁵⁰ MODEL CODE OF PROF'L RESPONSIBILITY Definition 1 (1983), *available at* <http://www.law.cornell.edu/ethics/aba/mcpr/MCPR.HTM> (last visited February 6, 2007).

incubator clients and other clients of the attorney that are not incubator clients.

The rules authorize an alternative to recusal for the attorney trapped in a conflict. Under MRPC Rule 1.7(b), an attorney may continue to represent a client with conflicting interests if:

- (1) the lawyer reasonably believes that the lawyer will be able to provide competent and diligent representation to each affected client;
- (2) the representation is not prohibited by law;
- (3) the representation does not involve the assertion of a claim by one client against another client represented by the lawyer in the same litigation or other proceeding before a tribunal; and
- (4) each affected client gives informed consent, confirmed in writing.⁵¹

CPR Disciplinary Rule 5-105(C) also authorizes the attorney to continue representation upon client consent.⁵² According to the older rule, “[A] lawyer may represent multiple clients if it is obvious that he can adequately represent the interest of each and if each consents to the representation after full disclosure of the possible effect of such representation on the exercise of his independent professional judgment on behalf of each.”⁵³

Despite the changed wording, the basic principle under both the new and old rules is the same; the lawyer needs to fully inform all the clients of the possible conflicts, and the clients potentially affected by the conflict must adequately demonstrate consent. However, there are some material differences that the practicing attorney should note. The MRPC requires the lawyer himself to reasonably believe that he is able to provide competent representation⁵⁴ while the CPR seems to require an objective determination.⁵⁵ The MRPC requires that consent be evidenced in writing,⁵⁶ while the CPR does not require a writing.⁵⁷ The MRPC requires compliance with other portions of the law regarding representation in order to comply with the ethics guidelines.⁵⁸ The CPR does not necessarily ignore this point, but it does not make compliance a part of the conflicts-consent test.⁵⁹

Thus, the rules do not necessarily prevent an attorney from simultaneously representing a business incubator and the incubator’s

⁵¹ MODEL RULES OF PROF’L CONDUCT R. 1.7, *supra* note 6.

⁵² See MODEL CODE OF PROF’L RESPONSIBILITY DR 5-105, *supra* note 6.

⁵³ *Id.*

⁵⁴ See MODEL RULES OF PROF’L CONDUCT R. 1.7, *supra* note 6.

⁵⁵ See MODEL CODE OF PROF’L RESPONSIBILITY DR 5-105, *supra* note 6.

⁵⁶ See MODEL RULES OF PROF’L CONDUCT R. 1.7, *supra* note 6.

⁵⁷ See MODEL CODE OF PROF’L RESPONSIBILITY DR 5-105, *supra* note 6.

⁵⁸ See MODEL RULES OF PROF’L CONDUCT R. 1.7, *supra* note 6.

⁵⁹ See MODEL CODE OF PROF’L RESPONSIBILITY DR 5-105, *supra* note 6.

clients.⁶⁰ While such relationships are conflicts of interests, nothing prevents all the concerned parties from giving consent to the representation.⁶¹ It is possible that the relationship between the incubator and incubator client could permit the parties to establish from the outset the types of conflicts that may arise and set up the proper procedural safeguards that satisfy the requirements for the particular jurisdiction.

The nature of the business incubation relationship is such that it should be *presumed* that consent is granted, and neither the newer MRPC nor the older CPR allows this. Incubator clients come to the business incubator because they want the incubator to be involved in their operations.⁶² Incubators accept the clients because they want to be involved in the operations.⁶³ The relationships are not hostile; they are mutually cooperative and highly involved.⁶⁴ By presuming, instead, that the incubator and incubator client are pursuing differing interests, the ethics rules place an additional burden on attorneys working in the incubator context which may discourage many attorneys from providing needed assistance to business incubators and incubator clients.⁶⁵

Furthermore, the mechanics for effective consent are unnecessary in business incubation. Comment 20 to MRPC Rule 1.7 explains:

Paragraph (b) requires the lawyer to obtain the informed consent of the client, confirmed in writing. Such a writing may consist of a document executed by the client or one that the lawyer promptly records and transmits to the client following an oral consent. . . . If it is not feasible to obtain or transmit the writing at the time the client gives informed consent, then the lawyer must obtain or transmit it within a reasonable time thereafter. . . . *The requirement of a writing does not supplant the need in most cases for the lawyer to talk with the client, to explain the risks and advantages, if any, of representation burdened with a conflict of interest, as well as reasonably available alternatives, and to afford the client a reasonable opportunity to consider the risks and alternatives and to raise questions and concerns.*⁶⁶

As discussed above, entities involved in business incubation do not need the risks and advantages of concurrent representation explained to them. The

⁶⁰ See S.C. Bar. Eth. Adv. Comm., Adv. Op. 98-05 (1998).

⁶¹ See *id.*

⁶² See NBIA, *supra* note 1.

⁶³ See *id.*

⁶⁴ See NBIA, *supra* note 3.

⁶⁵ See McAlpine, *supra* note 9, at 567.

⁶⁶ MODEL RULES OF PROFESSIONAL CONDUCT R. 1.7 cmt. 20 (2003), available at http://www.abanet.org/cpr/mrpc/rule_1_7_comm.html (last visited February 6, 2007) (emphasis added).

interconnectivity is the hallmark of business incubation; it is the reason the client companies seek out business incubators, and it is the reason business incubators operate the way they do. The risks are accepted, and the advantages are welcomed by implication. Consent to representation should also be implied.

Additionally, acquiring consent at the outset of representation in the business incubation context for future services is often ineffective. According to one source, the key issues in such advance waiver instances are “(1) whether the future ‘unrelated’ matter is adequately identified, (2) whether the party giving the waiver is adequately sophisticated, (3) whether the waiver is recent enough, and (4), in some cases, whether the waiving party had an opportunity to seek independent counsel’s advice on giving the waiver.”⁶⁷

These issues are burdensome for attorneys and may make it difficult for effective representation to occur within the business incubation context. In *Iowa S. Ct. Att’y. Disc. Bd. v. Clauss*, the Supreme Court of Iowa, in applying its version of CPR DR 5-105, ruled that an attorney must do more than simply disclose that the potential for conflict exists and then request a waiver of those potential conflicts.⁶⁸ An attorney is required to make a “full disclosure” under the rule,⁶⁹ and, according to the Court, this means the attorney must “explain in detail the pitfalls that may arise in the course of the transaction which would make it desirable that the [prospective client] obtain independent counsel.”⁷⁰

Other courts have also placed a heavy burden on an attorney seeking waiver based on the concern for full disclosure of conflicts. In *Worldspan L.P. v. The Sabre Group Holdings, Inc.*, a federal district court, interpreting Georgia’s version of CPR DR 5-105, declared that lapse of time could likely render any waiver ineffective.⁷¹ Furthermore, the court held that conflicts disclosure must specifically identify the particular conflict at issue, including references to parties, to be effective.⁷² In *Hasco, Inc. v. Roche*, the court held that a waiver was restricted to only those actions expressly detailed in the disclosure and could not extend to other actions between the same parties, even though the purpose of the waiver

⁶⁷ William Freivogel, *Waivers/Consents*, FREIVOGEL ON CONFLICTS, http://www.freivogelonconflicts.com/new_page_38.htm#Advance%20Waivers (last visited February 6, 2007).

⁶⁸ *Iowa S. Ct. Att’y. Disc. Bd. v. Clauss*, 711 N.W.2d 1, 3 (Iowa 2006).

⁶⁹ *Id.*

⁷⁰ *Id.*

⁷¹ *Worldspan L.P. v. The Sabre Group Holdings, Inc.*, 5 F. Supp. 2d 1356, 1358 (N.D. Ga. 1998).

⁷² *Id.* at 1360. Note, however, that the court states that the need for explicitness in disclosures is because “[t]he client-lawyer relationship . . . is based on mutual trust . . .” *Id.* at 1358. Considering that the incubator-incubator client relationship is also based on mutual trust, it would seem odd to restrict an attorney from practicing in a context where both mutually trusting parties request his or her services.

“was to waive all future conflicts of any nature.”⁷³ In *Concat LP v. Unilever, PLC*, a federal district court in California required an attorney to execute a more specific disclosure of conflicts subsequent to a general disclosure of potential conflicts if the original disclosure did not specifically address the conflict.⁷⁴

These cases demonstrate that full disclosure means explicit disclosure, which must include the exact parties in conflict and the exact claims over which waiver is sought. This rule impairs the lawyer’s ability to function in the business incubation system because business incubators often provide a wide array of services to a variety of business types.⁷⁵ Adequately identifying all the potential types of work an attorney may perform for each and every incubator client, now existing and yet to exist, is virtually impossible.

Furthermore, incubator clients are typically unsophisticated; hence, they turn to the incubator (and the attorney) for guidance regarding business (and legal) issues.⁷⁶ Additionally, because incubator clients, like most small businesses, tend to be cash-strapped,⁷⁷ seeking independent counsel regarding the potential conflict is probably not an option. Even if it were, at least one case suggests that it would still be of no avail under the rule.⁷⁸

B. Attorney Services as Part of an Incubator’s Bundle of Services

Related to the concurrent representation issues raised above is the issue of whether an attorney can make his or her services available to incubator clients as a part of an incubator’s bundle of services. Successful business incubation programs require interconnectivity and efficiency.⁷⁹ Incubators, thus, will typically offer client companies a bundle of services in exchange for a fee.⁸⁰ Because attorneys are critical to small business formation,⁸¹ providing legal services as a part of the bundle of incubator services makes logical sense. However, the ethics rules place restraints on an attorney when the attorney represents an organization rather than the organization’s constituents, and it is unclear whether the rule would apply

⁷³ *Hasco, Inc. v. Roche*, 700 N.E.2d 768, 776 (Ill. App. 1998).

⁷⁴ *Concat LP v. Unilever, PLC*, 350 F. Supp. 2d 796, 821 (N.D. Cal. 2004).

⁷⁵ See NBIA, *supra* note 1.

⁷⁶ See *id.*

⁷⁷ Cf. NBIA, *supra* note 5 (one of the primary goals of business incubators is to connect their start-up clients with funding sources).

⁷⁸ *Glidden Co. v. Jandernoa*, 173 F.R.D. 459, 480 (W.D. Mich. 1997) (“Where dual representation creates a conflict of interest, the burden is on the attorney involved to approach both clients with an affirmative disclosure and a request for express consent. Independent consultation with another lawyer by the opposing party is insufficient to satisfy the obligation of full disclosure.”).

⁷⁹ See NBIA, *supra* note 3.

⁸⁰ See NBIA, *supra* note 1.

⁸¹ See Rosen, *supra* note 8.

to an organization such as a business incubator and its constituent client companies.⁸²

Additionally, attorneys may be able to provide non-legal services to small businesses, such as accounting, business planning, or financial advising, thereby improving the interpersonal relationships between the attorney and incubator client and decreasing the incubator's need to find other competent experts. But again, the model rules limit an attorney's ability to adequately represent entities in the business incubation context.⁸³ As such, the model ethics rules do not accommodate the practical needs of entities involved in business incubation.

1. *Co-Representation of an Incubator and Incubator Clients*

Do ethics rules permit an attorney to represent both a business incubator and an incubator client at the same time as a part of the incubator's bundle of services? For the MRPC, Rule 1.13 guides when an attorney is representing an organizational client. Under Rule 1.13(a), a lawyer employed or retained by an organization owes full allegiance to the organization.⁸⁴ Thus, it would seem like the attorney's representation would be limited to either the incubator or the incubator client. However, this rule was probably crafted with traditional corporations in mind in order to deal with intracorporate conflicts such as derivative actions where the attorney may be providing legal advice to individual board members, since corporations may only act through such constituents.⁸⁵ Presumably, the conflicts potentially arising in the business incubator context do not include the same issues normally faced in intracorporate conflicts, so MRPC Rule 1.13(a) is probably not a concern.

Furthermore, even if MRPC Rule 1.13(a) did apply, Rule 1.13(g) provides an avenue for relief. Under that provision, an attorney representing an organization may also represent officers, directors, employees, shareholders, members, or other constituents, subject to the conflict of interest provisions of Rule 1.7.⁸⁶ Thus, as long as the constituents consent to the representation and otherwise comply with Rule 1.7, no issue should be raised under Rule 1.13. However, this also means that the concurrent

⁸² See MODEL RULES OF PROF'L CONDUCT R. 1.13 (2003), available at http://www.abanet.org/cpr/mrpc/rule_1_13.html (last visited February 6, 2007).

⁸³ See MODEL RULES OF PROF'L CONDUCT R. 5.7 (2003), available at http://www.abanet.org/cpr/mrpc/rule_5_7.html (last visited February 6, 2007).

⁸⁴ See MODEL RULES OF PROF'L CONDUCT R. 1.13, *supra* note 82.

⁸⁵ Darian M. Ibrahim, *Solving the Everyday Problem of Client Identity in the Context of Closely Held Businesses*, 56 ALA. L. REV. 181, 192 (2004); See also MODEL RULES OF PROF'L CONDUCT R. 1.13 cmt. 1 (2003), available at http://www.abanet.org/cpr/mrpc/rule_1_13_comm.html (last visited February 6, 2007).

⁸⁶ MODEL RULES OF PROF'L CONDUCT R. 1.13, *supra* note 82.

representation concerns raised above with regard to Rule 1.7 also may be present under Rule 1.13.

CPR Ethical Consideration 5-18 parallels MRPC 1.13 in proclaiming that an attorney only represent the organization, and may represent others only if the attorney believes that no conflict exists.⁸⁷ The language of the older EC 5-18 is also more encompassing in that it includes any “other person connected with the entity,”⁸⁸ with “person” including “any other legal entity.”⁸⁹ As such, it is not clear that the rule would apply only to corporations, directors, officers, and other insiders. Because of the high level of interconnectivity between business incubators and incubator client companies, such language could be construed to create a potential violation of the provision.

Both the MRPC and the CPR provisions provide a way out for the attorney in a business incubation context: consent. However, as discussed above, the avenue for relief may place the unwelcome burden of ensuring that all parties consent to the concurrent representation and that the waivers satisfy the statutory requirements. In a business incubator, it is understood that the parties must be highly interconnected. The relationship is not an adversarial one; it is a cooperative one. By presuming that the attorney only works to the advantage of one party and to the disadvantage of all other parties, the ethics rules ignore the reality of the relationship. It would make more sense to give attorneys working in such interconnected relationships the benefit of the doubt.

2. *Non-Legal Services Offered by Attorneys*

In addition to providing legal services, an attorney may provide non-legal services to clients. In fact, because of their special training and community contacts, and because of the financial limitations of small businesses, attorneys often are the best option for providing non-legal services.⁹⁰ Attorneys, therefore, represent an even greater resource for business incubators needing to maintain the most efficient operations possible.

Neither the MRPC nor the CPR prevents an attorney from providing non-legal services. However, under MRPC Rule 5.7, an attorney is subject to the Rules of Professional Conduct when providing “law-related

⁸⁷ MODEL CODE OF PROF'L RESPONSIBILITY EC 5-18 (1983), *available at* <http://www.law.cornell.edu/ethics/aba/mcpr/MCPR.HTM> (last visited February 6, 2007).

⁸⁸ *Id.*

⁸⁹ MODEL CODE OF PROF'L RESPONSIBILITY Definition 2 (1983), *available at* <http://www.law.cornell.edu/ethics/aba/mcpr/MCPR.HTM> (last visited February 6, 2007).

⁹⁰ See Jones, *supra* note 32, at 8-9.

services.”⁹¹ “Law-related services” are services that might reasonably be performed along with and are substantially related to legal services provided, and that are not prohibited as unauthorized practice of law when provided by a non-lawyer.⁹² However, the law-related services are only subject to the rule if they are provided:

- (1) by the lawyer in circumstances that are not distinct from the lawyer's provision of legal services to clients; or
- (2) in other circumstances by an entity controlled by the lawyer individually or with others if the lawyer fails to take reasonable measures to assure that a person obtaining the law-related services knows that the services are not legal services and that the protections of the client-lawyer relationship do not exist.⁹³

Essentially, the rule states that the lawyer is bound to the Rules of Professional Conduct when his non-legal services are not distinct from his legal services or when the lawyer fails to reasonably ensure that the recipient of the non-legal services is aware that the services are distinct and are offered by an entity the lawyer controls.⁹⁴

While there is no ethics rule against providing non-legal services, attorneys still need to be careful when doing so. MRPC Rule 5.7 has been criticized as failing to recognize that the primary concern should be whether or not the client may reasonably believe that the privileges of attorney-client privilege extend to the services performed.⁹⁵ Instead, the rule imposes the privilege only when an entity controlled by the lawyer provides the services and the lawyer fails to ensure that the client recognizes that the privilege does not apply.⁹⁶ According to one court, the attorney-client privilege should apply if (1) the asserted holder of the privilege is, or sought to become, a client; (2) the person to whom the communication was made is acting as a lawyer; (3) the communication was made for the purpose of securing primarily either an opinion of law, legal services, or assistance in some legal proceeding; and (4) the privilege has been claimed and not waived by the client.⁹⁷ The court, thus, removes the controlled-entity requirement from the test.⁹⁸

Furthermore, MRPC Rule 1.6(a) states that an attorney is not authorized to reveal information regarding the client unless (1) the client gives informed consent, (2) the authorization is implied in order to carry out

⁹¹ MODEL RULES OF PROF'L CONDUCT R. 5.7, *supra* note 83.

⁹² *Id.*

⁹³ *Id.*

⁹⁴ Andrew M. Goldner, Note, *Minding Someone Else's Businesses: Pennsylvania Rule of Professional Conduct 5.7 Leads the Way*, 11 GEO. J. LEGAL ETHICS 767, 774 (1998).

⁹⁵ See *id.* at 779.

⁹⁶ MODEL RULES OF PROF'L CONDUCT R. 5.7, *supra* note 83.

⁹⁷ *Deutsch v. Cogan*, 580 A.2d 100, 103-04 (Del. Ch. 1990).

⁹⁸ *Id.*

the representation, or (3) is otherwise authorized by the rules.⁹⁹ Thus, under Rule 5.7, an attorney will be subject to Rule 1.6 if providing law-related services, rather than merely providing pure legal services, and Rule 1.6 requires the attorney not to reveal representational information. However, because business incubators and business incubator clients are by their very nature interconnected,¹⁰⁰ it is necessary for the lawyer to reveal representational information about each entity to the other.

The rules get even trickier when dealing with unintentional clients. An attorney's client may become a client either expressly or impliedly.¹⁰¹ Thus, an attorney may wind up in an attorney-client relationship with a client—and be required to maintain confidentiality—unintentionally. To create an implied attorney-client relationship, the purported client must show (1) that it submitted confidential information to the attorney, and (2) that it did so under a reasonable belief that the attorney was serving as its lawyer.¹⁰² Because attorneys in the business incubation context may be offering non-legal as well as legal services, there may be confusion among clients as to whether there is legal representation. If the client is under a reasonable belief that an attorney-client relationship exists, Rule 1.6 may prevent the sharing of information among incubators and incubator clients, a necessity in the business incubator context.

C. Equity Compensation

More and more, attorneys and law firms are exchanging their services for equity positions in their business clients instead of cash.¹⁰³ Doing so provides an easy capital source for the small business (which more than likely is highly cash-strapped) and reduces transaction costs by making it easier for the small business to identify potential sources of capital.¹⁰⁴ Small businesses in business incubators are no different. Thus, compensating the attorney with equity for services rendered in lieu of cash would be advantageous to incubator clients.

However, the current ethics rules frown upon such practices.¹⁰⁵ According to MRPC Rule 1.8, an attorney may not obtain an ownership interest in a client that is adverse to a client unless (1) the transaction and terms are fair and reasonable to the client, fully disclosed, and reduced to a writing that can be reasonably understood by the client; (2) a writing advises the client of the desirability of seeking independent counsel, and

⁹⁹ MODEL RULES OF PROF'L CONDUCT R. 1.6 (2003), *available at* http://www.abanet.org/cpr/mrpc/rule_1_6.html (last visited February 6, 2007).

¹⁰⁰ *See* NBIA, *supra* note 3.

¹⁰¹ *Montgomery Academy v. Kohn*, 50 F. Supp. 2d 344, 350 (D. N.J. 1999).

¹⁰² *Id.*

¹⁰³ *See* Dzienkowski & Peroni, *supra* note 45, at 407-15.

¹⁰⁴ McAlpine, *supra* note 9, at 569.

¹⁰⁵ *See* MODEL RULES OF PROF'L CONDUCT R. 1.8, *supra* note 7.

reasonable opportunity is provided to seek independent counsel on the transaction; and (3) the client provides informed, written, and signed consent to the essential terms of and the lawyer's role in the transaction.¹⁰⁶

Several potential issues arise. First, there is the relatively unsophisticated nature of entrepreneurs with businesses that are clients of some incubators.¹⁰⁷ These entrepreneurs may not be able to realistically understand the technicalities and legal issues surrounding an equity transaction. Second, it may be impossible for the small business to obtain independent counsel for the transaction; the small business is seeking the equity-for-services transaction because it is cash strapped and unable to pay cash for attorney representation. Finally, the language of the rule indicates that the equity transaction is forbidden if it would be adverse to *any* client.¹⁰⁸ Thus, the attorney is required to keep in mind the demands of all the incubator clients the attorney represents as well as the incubator itself when deciding to take an equity stake in any one incubator client.

The older CPR DR 5-104 forbids all business transactions with clients where the parties may have differing interests, unless the client consents. Therefore, the consent issues discussed above are raised under both the newer and older versions of the model rules.

III. A BETTER PARADIGM: ACCOMMODATING THE NEEDS OF THE INCUBATOR SYSTEM

As discussed above, various aspects of the model ethics rules place significant restraints on the ability of a lawyer to effectively function as needed in the business incubator system. While the ethics rules presume that parties to a transaction are purely self-interested and, therefore, require an attorney to pick the side for which he will advocate,¹⁰⁹ entities engaging in business incubation transactions are cooperative and mutually dependent.¹¹⁰ Furthermore, often the only potential way to facilitate attorney involvement in small business development is to allow a degree of attorney self-dealing,¹¹¹ to which the ethics rules also take a heavy handed approach under the presumption that the lawyer is taking advantage of his client.¹¹² Compounding the situation is the confusing and often conflicting

¹⁰⁶ *Id.*

¹⁰⁷ See NBIA, *supra* note 1.

¹⁰⁸ *Id.*

¹⁰⁹ See MODEL RULES OF PROF'L CONDUCT R. 1.7, *supra* note 6; see also MODEL CODE OF PROF'L RESPONSIBILITY DR 5-105, *supra* note 6; see also *Concat LP v. Unilever, PLC*, *supra* note 74, at 819 ("When evaluating whether a law firm may concurrently represent two clients, even on unrelated matters, it is presumed that the duty of loyalty has been breached and counsel is automatically disqualified.").

¹¹⁰ See NBIA, *supra* note 3.

¹¹¹ See McAlpine, *supra* note 9, at 557-58.

¹¹² *Id.*, at 552.

guidance from the courts as to when a lawyer's co-representation and self-dealing is a violation of ethics duties.¹¹³ Thus, a new, clear paradigm of the relationships between lawyers and multiple parties in certain transactional relationships is needed to ensure that business incubators and business incubator clients can receive effective legal counsel.

A. *A Realistic Approach to Conflicts of Interest*

As discussed above, business incubation requires involvement of business incubators in the operations of incubator clients as well as the dependence of incubator clients on the incubators for survival.¹¹⁴ An attorney working in such an environment must be able to strike a balance between the competing needs of the parties. This is similar to the situation faced by the attorney working in the context of a close corporation wherein several individuals come to a single attorney for assistance with setting up a corporation in which each will have an interest. As such, a possible new paradigm for business incubators is one taken by some commentators and courts in regard to closely-held corporations.¹¹⁵ Under this so-called "aggregate theory," the lawyer represents not only the firm but also all of the constituents in aggregate.¹¹⁶ The basic idea is that, as a practical matter, the close corporation is usually better off if the lawyer represents all the interested parties, so representation of all the parties should be the rule rather than the exception.¹¹⁷

However, the aggregate theory's effectiveness is limited because it still requires the lawyer to recuse him or herself from representing any party once a conflict does arise.¹¹⁸ Thus, while the aggregate theory may better represent the notion that business incubator service offerings necessitate

¹¹³ See generally Ze'ev Eiger & Brandy Rutan, Comment, *Conflicts of Interest: Attorneys Representing Parties with Adverse Interests in the Same Commercial Transaction*, 14 GEO. J. LEGAL ETHICS 945, 960-61 (2001). Eiger and Rutan highlight cases in various states and the application of the ethics rules to various business transactions, and conclude that the case law does not "establish discernable legal trends or illuminate prior case law to guide attorneys seeking to represent parties with adverse interests in commercial transactions." However, Eiger and Rutan also conclude that courts generally presume that clients in certain transactional relationships (such as lender-borrower, seller-purchaser, majority-minority shareholder, corporation-corporate officer, and general-limited partner) are naturally adverse.

¹¹⁴ See NBIA, *supra* note 3.

¹¹⁵ Ibrahim, *supra* note 85, at 192; *In re Banks*, 584 P.2d 284, 290 (Or. 1978); *In re Brownstein*, 602 P.2d 655, 657 (Or. 1979).

¹¹⁶ Ibrahim, *supra* note 85, at 193. For a discussion of when it is appropriate to invoke such a rule, see Lawrence E. Mitchell, *Professional Responsibility and the Close Corporation: Toward a Realistic Ethic*, 74 CORNELL L. REV. 466, 506-08 (1989).

¹¹⁷ See Mitchell, *supra* note 116.

¹¹⁸ *Banks*, *supra* note 115, at 292 ("[T]he only ethical position for an attorney to adopt when substantially identical interests which he has represented become divergent is to represent neither the individual nor the corporation.").

interconnectivity, it still does not provide a solution to whether an attorney may represent both the incubator and the incubator client when conflicts arise. If anything, the attorney would be disallowed from representing either party when a material conflict arose,¹¹⁹ leaving incubators and clients no choice but to seek additional counsel (and accumulate additional expenses) in order to obtain any legal representation.

A different concept of the attorney-client relationship may make more sense in the business incubator context. This construct has been termed the "Framework of Dealing" or "counsel for the situation" approach.¹²⁰ According to the Framework of Dealing approach, in the context of a close corporation:

The corporation derives its unity from a legal structure designed to reconcile the interests of its constituents. . . . Understood in terms of its full legal structure, the corporation's identity includes, in addition to a set of decision-making procedures, a substantive commitment that its constituents be treated fairly. Thus, a corporation has an interest in the fair treatment of its constituents.¹²¹

A business incubator can be thought of similarly. The necessary interconnectivity among the incubator and incubator clients requires that the incubator make a substantial commitment that the client firms be treated fairly.¹²²

Under the Framework of Dealing approach, the attorney does not choose one party to advise in a conflict, nor must the attorney recuse himself when particular interests within the aggregate differ.¹²³ Instead, the attorney serves as counsel for the situation.¹²⁴ The attorney looks at the issue substantively as a referee and issues an opinion as to the legal rights of all parties involved.¹²⁵ If the attorney cannot determine the substantive merits of the dispute, then the attorney is to remain neutral.¹²⁶ However, such a construct may be valid only if each party is represented by an additional, independent counsel.¹²⁷ As in the aggregate theory approach, a

¹¹⁹ See Ibrahim, *supra* note 85, at 199.

¹²⁰ William H. Simon, *Whom (Or What) Does the Organization's Lawyer Represent?: An Anatomy of Intraclient Conflict*, 91 CALIF. L. REV. 57, 88 (2003). Simon attributes the phrase "counsel for the situation" to Louis Brandeis, who used the strategy in one particular instance. Brandeis stated that his goal was "to give everybody, to the best of [his] ability, a square deal" and "to see that everybody got his legal rights." (citing Alpheus Thomas Mason, *BRANDEIS: A FREE MAN'S LIFE* 233-34 (1956)).

¹²¹ See Simon, *supra* note 120, at 86.

¹²² See NBIA, *supra* note 3.

¹²³ See Simon, *supra* note 120, at 86-87.

¹²⁴ *Id.* at 88.

¹²⁵ *Id.* at 86-88.

¹²⁶ *Id.* at 87-88.

¹²⁷ Posting of Charles E. Lundberg, CHUCKL@bassford.com, to Association of Professional Responsibility Lawyers Listserv (Dec. 2, 2006) (on file with author).

small business's ability to obtain counsel is made even more difficult once a conflict arises by the need for additional expenses.

The better approach would simply be to create an exception within the current rules that where the very nature of the relationships of the parties is highly interconnected and cooperative, and although the potential for future differences may exist, as long as the parties are not hostile, consent to representation should be presumed. Business incubators need a framework of organizational representation that recognizes their holistic nature. The incubator provides many services to clients, including operating space, but also business advice, certain management services, and financial access.¹²⁸ The ethics approach to client representation issues needs to recognize that incubator clients are dependent on the incubator for many of the essential business functions that a traditional corporation would perform for itself. The current rules do not allow for such, and, therefore, the exception needs to be allowed.

B. More Flexibility Needed for Consent Waivers

The current rules are also too rigid with regard to consent waivers. Under MRPC Rule 1.7, it is the attorney's responsibility to acquire "informed consent, confirmed in writing."¹²⁹ The Comments to the Rule state that, with regard to consent to future conflict, such consent is usually ineffective where it is general and open-ended.¹³⁰ However, considering the variety of incubator-types,¹³¹ incubator-client types,¹³² service offerings,¹³³ and economic circumstances that differ from incubator system to incubator system,¹³⁴ it would be near impossible for an attorney to identify and explain every type of instance in which a conflict may arise to an incubator or incubator client. Additionally, considering the necessity of incubator flexibility¹³⁵ and interconnectivity in the relationship,¹³⁶ limiting the types of representation an attorney can provide based on the attorney's ability to identify those matters at the outset of the relationship would prevent the attorney from providing all the services that the clients need.

Incubators and incubator clients need attorneys to be flexible;¹³⁷ the rules should be equally flexible in order to accommodate effective

¹²⁸ See NBIA, *supra* note 1.

¹²⁹ MODEL RULES OF PROF'L CONDUCT R. 1.7, *supra* note 6.

¹³⁰ MODEL RULES OF PROF'L CONDUCT R. 1.7 cmt. 22 (2003), *available at* http://www.abanet.org/cpr/mrpc/rule_1_7_comm.html (last visited February 6, 2007).

¹³¹ See NBIA, *supra* note 1.

¹³² See *id.*

¹³³ See *id.*

¹³⁴ See *id.*; see also NBIA, *supra* note 5.

¹³⁵ See NBIA, *supra* note 1.

¹³⁶ See NBIA, *supra* note 3.

¹³⁷ See NBIA, *supra* note 1.

representation. Because the relationship between business incubators and business incubator clients is so interconnected,¹³⁸ the ethics rules guiding attorneys should acknowledge that consent to concurrent representation is implied by the very existence of the incubator-incubator client relationship.

C. Attorney Confidence and the Necessity of Revealing Information

Because of their unique arrangements, attorneys for incubator clients are in perhaps the best position to offer certain non-legal services along with their legal services.¹³⁹ Furthermore, because the relationship between the business incubator and its clients is highly dependent on communication between the constituent entities,¹⁴⁰ attorneys for incubator clients must be able to provide privileged information regarding the status of the incubator clients to the business incubator. While Rule 1.6 may be a hurdle to effective communication and representation by an attorney in the business incubation context, it allows disclosure when it is “impliedly authorized in order to carry out the representation.”¹⁴¹

In the business incubation context, the consent to communicate should be implied by the close nature and interconnectedness of the constituent entities. Thus, the rules probably do not significantly limit an attorney working in business incubation from sharing information with the incubator and the incubator client.

D. Equity Compensation and the Need to Consider Context

As discussed above, often a small business may only be able to obtain effective legal representation through creative attorney-compensation schemes, such as equity compensation.¹⁴² However, MRPC Rule 1.8 places strict requirements on transactions between attorneys and clients, including equity-for-legal services transactions.¹⁴³ Instead, the ethics guidelines presume that an attorney entering into a business transaction with a client is taking advantage of the client.¹⁴⁴ This approach ignores the reality of many equity compensation transactions and closes off an option that business incubators and incubator clients could use to attract quality legal representation.

In order to successfully navigate the requirements for attorney equity compensation transactions, one commentator, Antonella Popoff, makes several recommendations, including (1) limiting the size of the

¹³⁸ See NBIA, *supra* note 3.

¹³⁹ See Jones, *supra* note 32.

¹⁴⁰ See NBIA, *supra* note 1; see also NBIA, *supra* note 3.

¹⁴¹ MODEL RULES OF PROF'L CONDUCT R. 1.6, *supra* note 99.

¹⁴² See McAlpine, *supra* note 9, at 557-58.

¹⁴³ See MODEL RULES OF PROF'L CONDUCT R. 1.8, *supra* note 7.

¹⁴⁴ See McAlpine, *supra* note 9, at 552.

investment so that there is little if any concern regarding control, domination, or conflict; (2) taking the bulk of fees in cash; (3) using independent third parties to value the investment; (4) providing detailed disclosures of conflicts; (5) disclosing stock ownership when appropriate; and (6) remaining impartial in board and management disputes.¹⁴⁵ However, these recommendations do not help business incubator clients much. The point of offering equity in lieu of cash is to save as much cash as possible, and the point of offering the equity to the lawyer is to reduce costs by having to find independent investors.¹⁴⁶ Popoff's recommendations ignore these needs.

Instead, the better course is for courts and rule-makers to acknowledge that the rules were not drafted to cover situations like those present in incubators where the parties are mutually cooperative, dependent, and highly interconnected. One commentator argues that for equity investments in high-growth company clients attorneys should not be required to comply with the ethics rule.¹⁴⁷ Instead, basic fiduciary duties provide more flexibility to the attorney, who needs to be adaptive to the needs of individual clients.¹⁴⁸ Community norms developed around start-up and equity financiers provide a better gauge for ethics violations than bright-line rules designed to prevent an attorney from compromising one client for the sake of another hostile client.¹⁴⁹

Such an approach also makes sense in the business incubation context. An attorney's incentive derives as much from the desire to maintain business relationships with the business incubator and incubator clients as much as it does from the threat of ethics violations.¹⁵⁰ Helping the small businesses out by taking equity in lieu of cash also strengthens the interconnectedness of the constituent entities; the attorney's own welfare is dependent on his or her ability to provide competent services and assist the incubator clients toward growth.¹⁵¹

¹⁴⁵ Antonella T. Popoff, *Lawyers Taking Equity Interests in Internet Companies Must be Alert to Special Ethical Risks*, 74 N.Y. St. B.J. 19, 21 (2002).

¹⁴⁶ See McAlpine, *supra* note 9, at 572-75.

¹⁴⁷ See *id.* generally.

¹⁴⁸ See *id.* at 567-68.

¹⁴⁹ See *id.* at 587.

¹⁵⁰ Cf. McAlpine, *supra* note 9, at 569-82. McAlpine reviews various advantages for both clients and lawyers engaging in equity acquisitions. When a lawyer has a personal financial stake in a client company, that lawyer will be more inclined to ensure that the client has the proper procedures and relationships to best situate itself for long term success. *Id.* at 574-75.

¹⁵¹ See McAlpine, *supra* note 9, at 574-75. Considering that in business incubation, the business incubator's goal is also to ensure that its small business clients have the proper procedures and relationships in place to best situate themselves for long term success as well as financing sources (NBIA, *supra* note 1), it may be of even greater advantage to utilize attorney equity compensation schemes in the business incubation context than in normal small business attorney representation.

IV. CONCLUSION

In the context of a business incubator, an attorney must make sure to avoid tripping over any ethics violation. The highly interconnected nature of a business incubator and its client companies¹⁵² can easily result in conflicts of interest among all the parties involved in the operation. Concurrent representation of the business incubator and business incubator clients may require a special relational construct that the current versions of the model ethics rules do not recognize or appreciate.

Rather than requiring attorneys to obtain consent from all parties in concurrent representation and equity compensation instances, the rules should acknowledge their own limitations and provide exceptions where the potentially conflicted parties are highly interconnected. In such instances, the attorney must be able to disclose information among clients, structure transactions with all clients in mind, and provide services in the manner that are most helpful for all clients. The current rules do not allow attorneys to do this, and, therefore, need revision.

Additionally, when attorneys do attempt to obtain waivers from clients for potential conflicts, the rules do not allow the necessary flexibility in identifying future conflicts required in the business incubation context. Business incubators come in a variety of types, serving a variety of clients, offering a variety of services, and operating in a variety of economic contexts;¹⁵³ it would be extremely difficult for an attorney to accurately identify all potential conflicts at the outset of representation. Any waiver of conflicts would almost necessarily have to be open and general, which are the exact kind of waiver that the commentaries to Rule 1.7 frown upon.¹⁵⁴ Thus, the very nature of the business incubation construct conflicts with the ethics rules' conceptualization of waiver. The easiest way for courts to address this would be to recognize that the rules were not drafted with business incubators in mind and to craft an exception to the rule.

Finally, the ethics rules impose restrictions that are too harsh on transactions between lawyers and clients to accommodate effective representation in the business incubation setting. The rules presume that an attorney entering into a business deal with a client is taking advantage of the client.¹⁵⁵ This presumption ignores the economic reality that an attorney whose compensation is dependent on the success of a business client will have an even greater incentive to promote the client's success through his representation.¹⁵⁶

The rules simply were not drafted with mutually dependent, cooperative entities in mind. As such, attorneys working in an environment

¹⁵² See NBIA, *supra* note 3.

¹⁵³ See NBIA, *supra* note 1.

¹⁵⁴ MODEL RULES OF PROF'L CONDUCT R. 1.7 cmt. 22, *supra* note 130.

¹⁵⁵ See McAlpine, *supra* note 9, at 552.

¹⁵⁶ See *id.*, at 574-75.

such as a business incubator should not be required to adhere to the ethics rules restricting the use of equity compensation. Instead, more flexible standards of fraud and community norms would provide entities and attorneys with the ability to tailor compensation packages to meet their personal needs while at the same time providing adequate protection against abuse.

